May 27, 2014

Mr. Gerard Poliquin

Secretary to the NCUA Board

1775 Duke Street
Alexandria, VA 22314

Re: RIN 3133–AD77 Comments on Proposed Rule: PCA— Risk-Based Capital

As a member of, and currently serving as the Chief Credit Officer of Affinity Federal Credit Union, Basking Ridge, NJ, I would like to provide the following comments regarding the February 2014 National Credit Union Administration (NCUA) proposed risk based capital rule. I appreciate the opportunity to share my thoughts on this far reaching regulatory proposal, to express some of my concerns about the potential negative impact of the proposed rule on credit unions if finalized in its current form and to offer some suggested improvements in the rule for your consideration as you move forward in the rulemaking process.

Affinity, a $2.3 billion credit union with 134,000+members, was chartered in 1935 to serve members' financial needs. I view this current proposal from NCUA to be a redirection of that charter away from members. If approved as currently written, NCUA's proposed Risked Based Capital regulation will drive a culture of risk avoidance and a focus on capital accumulation rather than on serving the financial needs of our members. The economic vitality of this nation rests with the ability for small and mid-sized businesses' ability to access capital and lending along with home mortgages and ownership for those individuals who qualify.

Risk is a part of everyone's lives. Risk must be managed and mitigated, but cannot be avoided. Capital must be accumulated by serving members and managing the risk that is inherent in providing that service, yet member service is always first and foremost.

Let me offer my thoughts on specific provisions of the proposed rule and suggest ways to improve the rule and the intended outcome. As the former head of credit risk management for Morgan Stanley's Global Wealth Management unit, part of my responsibility was to develop Basel I compliance originally as prescribed by the Securities and Exchange Commission (SEC) and, subsequent to the financial crisis of 2008, my team developed the framework for Basel II compliance as prescribed by the Federal Reserve Bank (FRB) and the Office of the Comptroller of the Currency (OCC). This framework ran across the full range of both credit and noncredit sensitive products as offered by Morgan Stanley. Accordingly, I feel most qualified to offer my perspective and comments.

As a start, we have just gone through the most significant financial crisis the world has ever seen and natural person credit unions, individually and collectively, had more than adequate levels of capital based on the current statutory levels established by Congress. Not only did they have capital, but they built capital during the crisis. Affinity Federal Credit Union **did not** participate in the TARP program as was required for so many banks and investment firms. In other words, there is absolutely no logical reason to require the significantly higher amounts of capital being proposed. Our concerns include but are not limited to the points noted below.

Individual Minimum Capital Ratio (IMCR): The biggest and most dangerous proposal is the IMCR. It is totally subjective authority given to examiners and it overrides all risk weighting or leverage ratio outcomes. This part of the rule must be totally stricken and never allowed in any regulatory environment.

Inconsistency with bank calculation of Risk Weighted Assets (RWA): The proposed rule attempts to incorporate multiple types of financial risk exposures into one set of metrics. One of NCUA's goals is to have PCA metrics that address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk." Neither Basel III nor the FDIC Interim Final Rule attempts to capture interest rate risk, liquidity risk, market risk, or operational risk in its risk weightings. The bank rules address credit risk in the PCA metrics. FDIC acknowledges that risk exposures and factors other than credit risk may call for an institution to increase its capital levels but employs supervisory assessments, rather than PCA risk weightings, to tailor an individual institution's required capital to its risk profile. NCUA's approach puts credit unions at a distinct disadvantage to community bank competitors.

The rule discourages real estate and member business loans and is punitive with respect to a credit union's investment portfolio because it includes concentration risk multipliers for real estate and member business loans and interest rate risk multipliers for investments. Risk weights increase as the % of assets in real estate and member business loans increase. Risk weights for investments increase as a function of the investments weighted average life. Credit unions would require significantly more capital than a community bank requires to support these portfolios. This will put the entire credit union industry at a huge competitive disadvantage to community banks and quite frankly, banks of all sizes.

Impact on credit availability & competitive disadvantage: Including interest rate risk multipliers for the investment portfolio and concentration risk multipliers for mortgages and member business loans is contrary to the other federal regulator's PCA rules. The concentration risk multipliers on mortgages and member business loans will not only limit supply of these loans but will also impact pricing of loans to members. If banks have a lower capital requirement, they can price differently. Should NCUA be an arbiter in influencing the market's pricing for critical sectors such as mortgages and small business loans? Should NCUA propose rules that will cause credit unions to lose market share and impede their ability to grow and grow capital? I cannot emphasize enough the important role credit unions have played for generations in serving the financial needs of its members through a number of economic cycles.

Impedes ability to build capital: The proposed rule creates a bias in favor of consumer loans. It is clear that NCUA prefers assets that are short term and is partial to retail unsecured exposures. This, along with the severe investment portfolio risk weights, will force credit unions down the yield curve to short duration assets and impede the ability to build capital. This overly prescriptive and onerous regulation essentially dictates the credit union's balance sheet structure and minimizes the board and management's ability to take calculated risk on behalf of members or structure an investment portfolio that balances risk and return. That is not the job of a regulator. One of the 5 C's of credit is collateral. All residential mortgages and small business loans have collateral as part of the requirement for financing. Collateral gives borrowers the incentive to pay back the loans they owe to the financial institution. Increasing unsecured credit should not be one of the unintended consequences of this proposal.

CUSOs: The risk weight applicable to CUSOs is flawed. It is entirely too conservative and is contrary to the credit union's DNA-cooperative efforts to serve members and enhance the

Numerator: Deducting the NCUSIF from capital assumes that this asset is essentially worthless. Treating this asset as impaired is contrary to GAAP and irrational given that its value is continually preserved through assessments.

The simple solution to all of the problems of this new proposal is to adopt the BASEL III/Community Bank model and completely remove the examiner discretion provision. Basel III was designed to align all regulatory bodies (including the NCUA) across the globe in a framework of capital adequacy and proper risk management.

One final suggestion is to allow all natural person credit unions to access secondary or supplemental capital. Capital access is a more constructive approach to achieving capital objectives than actions such as driving out deposits, shrinking assets, curtailing lending or reducing investments in the people, systems, marketing and branching required to win business, secure technology and serve members.

Thank you very much for the opportunity to comment on this proposed regulation. While I support the efforts of NCUA to pursue a balanced risk-based capital system, the proposal in its current form is overzealous and results in undermining the value of the credit union charter. I respectfully encourage NCUA to consider some of the recommended improvements to the proposal contained herein. With the right changes, this rule can become a source of long term viability of the credit union charter. If I can be a source of any further information on this comment letter, please do not hesitate to contact me.

Kind regards,

Scott O. Witherspoon

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